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DEPARTMENT OF TELECOMMUNICATIONS AND ENERGY**

**Investigation by the Department on its own motion as)
to the propriety of the rates and charges set forth in)
the following tariff: M.D.T.E. No. 14, filed with the) D.T.E. 06-61
Department on June 16, 2006, to become effective July)
16, 2006, by Verizon New England, Inc. d/b/a Verizon
Massachusetts**

REBUTTAL PANEL TESTIMONY

OF

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EXHIBIT AA/WF-4

**Excerpt From Verizon Virginia Inc.'s
Panel Testimony on Unbundled Network
Elements and Interconnection Costs**

RECEIVED

Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C. 20554

JUL 31 2001

FEDERAL COMMUNICATIONS COMMISSION
OFFICE OF THE SECRETARY

In the Matter of
Petition of WorldCom, Inc. Pursuant
to Section 252(e)(5) of the
Communications Act for Expedited
Preemption of the Jurisdiction of the
Virginia State Corporation Commission
Regarding Interconnection Disputes
with Verizon Virginia Inc., and for
Expedited Arbitration

CC Docket No. 00-218

In the Matter of
Petition of Cox Virginia Telecom, Inc., etc.

CC Docket No. 00-249

In the Matter of
Petition of AT&T Communications of
Virginia Inc., etc.

CC Docket No. 00-251

VERIZON VIRGINIA INC.

VOLUME III OF IV

**PANEL TESTIMONY ON UNBUNDLED NETWORK ELEMENT
AND INTERCONNECTION COSTS (CONTINUED)
(Public Version)**

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VERIZON VIRGINIA INC.

**Testimony of Donald Albert, Ralph Curbelo, Joseph Gansert,
Nancy Matt, Louis Minion, Carlo M. Peduto II, Gary Sanford,
and John White**

July 31, 2001

**VERIZON VIRGINIA INC. PANEL TESTIMONY ON
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1 XIII. RESALE DISCOUNT

2 (JDPL Issues II-1-a; II-1-d; II-2-d; IV-30; IV-36)

3 Q. What is the purpose of this section of the testimony?

4 A. The purpose of this section of the testimony is to describe the methodology
5 that Verizon VA has used to determine the appropriate discounts that apply
6 when Verizon VA's retail telecommunications services are resold by carriers
7 pursuant to § 251(c)(4) of the Telecommunications Act of 1996. We have
8 filed an avoided cost study with supporting tabs that identifies the specific
9 costs Verizon VA avoids in making its retail telecommunications services
10 available for resale in Virginia. There are two scenarios presented. One is
11 where the reseller continues to use Verizon VA Operator Services and
12 Directory Assistance (OS/DA). The other is where the reseller uses its own
13 platform (or the platform of a third party other than Verizon VA) to provide
14 OS/DA functions.

15

16 Q. Please explain the term "resale discount rate."

17 A. It is the discount applied to Verizon retail rates in determining the price
18 resellers pay for Verizon telecommunications services available for resale.
19 The rate is calculated by determining the costs that Verizon actually avoids
20 when providing resale services and dividing this figure by the revenues
21 Verizon receives for these services at retail.

22

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- 1 **Q. Does the avoided cost study that you are presenting comply with current**
2 **federal law?**
- 3 A. Yes. On July 18, 2000, the Eighth Circuit issued its decision in *Iowa Utils.*
4 *Bd. v. FCC*, 219 F.3d 744 (8th Cir. 2000), *cert. granted sub nom., Verizon*
5 *Communications Inc. v. FCC*, 121 S. Ct. 877 (2001), finding that the retail
6 avoided costs are only those that “the ILEC will *actually avoid* incurring in
7 the future, because of its wholesale efforts, not costs that ‘can be avoided.’”
8 *Id.* at 755 (emphasis added). The Eighth Circuit also ruled that the avoided
9 costs should recognize that the ILEC would continue to offer its services for
10 retail. On January 22, 2001, the Supreme Court of the United States granted
11 a petition for writ of certiorari in Docket No. 96-3321 with respect to the
12 Eighth Circuit’s decision, but certiorari was limited to three questions, none
13 of which involves the methodology to be used in calculating the retail
14 avoided costs. As a result, the Panel understands that the decisions reached
15 by the Eighth Circuit on this issue represent the final word on the applicable
16 law. Verizon’s retail avoided costs calculations are designed to comply with
17 the guidance provided by the Eighth Circuit.
- 18
- 19 **Q. Is the avoided cost study presented here for purposes of determining the**
20 **resale discount rate the same avoided cost study used in the calculation**
21 **of the annual cost factors?**

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1 A. Yes.

2 **A. METHODOLOGY**

3 **Q. Please describe the methodology that you used to determine Verizon**
4 **VA's actual avoided costs.**

5 A. To calculate the resale discount, Verizon VA analyzed its expenses by
6 function codes, which are used for accounting purposes to correlate Verizon
7 VA expenses with specific activities or functions. This information was
8 taken from Verizon VA's 1999 functional accounting data, which is kept in
9 the ordinary course of business. Verizon VA used 1999 data because it was
10 the most current annual period for which complete accounting information
11 was available. (VZ-VA CS, Vol. VIII, Part F-6, Tab 13 provides a short
12 description of each of the function codes)

13 Verizon VA analyzed this data as follows:

14 (1) The total company expenses at the function code detail (VZ-VA CS,
15 Vol. VIII, Part F-6, Tab 5, Pages 1-13, Column E) were multiplied by
16 the Part 64 regulated factors (Column F), which yields regulated
17 expenses by function code (Column G). From this number, Verizon
18 deducted expenses relating to Shared Network Facilities
19 Arrangements (SNFA) and Other Adjustments (Column H) to yield
20 the Adjusted Regulated Expenses (Column I). These expenses are
21 "subject to separations." (As explained in more detail below,

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1 expenses are allocated between the intrastate and interstate
2 jurisdictions through the separations process.) These “subject to
3 separations” expenses were multiplied by the intrastate separations
4 factors (Column J), resulting in the identification of intrastate
5 expenses by function code (Column K). See VZ-VA CS, Vol. VIII,
6 Part F-6, Tab 5, Pages 1 to 13.

7 (2) Verizon VA removed the expenses associated with Call
8 Completion/Number Services and Operators Systems from intrastate
9 expenses to develop the avoided cost discount when the reseller opts
10 not to use Verizon’s operators.

11 (3) Verizon VA examined each function code associated with services
12 available for resale to determine whether the function would be
13 avoided if a subscriber were to receive service from a reseller. The
14 results of that review are summarized in VZ-VA CS, Vol. VIII, Part
15 F-6, Tab 4 and detailed in VZ-VA CS, Vol. VIII, Part F-6, Tab 6,
16 Pages 1-19, Columns H through O. As noted above, the avoided
17 costs vary depending on whether the reseller uses Verizon VA’s
18 OS/DA. Furthermore, as discussed in more detail below, the
19 expenses and revenues associated with Operator Services were
20 examined to determine the avoided costs associated with non-revenue
21 producing operator calls when the reseller is providing their own

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1 operator services platform. See VZ-VA CS, Vol. VIII, Part F-6, Tab

2 11.

3 (4) Verizon VA identified the avoided expenses for indirect functions

4 (i.e., certain function codes within the corporate operations and

5 general support accounts). Only those indirect expenses that vary

6 with the level of retail output are avoided.

7 (5) Once Verizon VA determined the avoided costs, it calculated the

8 resale discount by dividing total avoided direct costs and total avoided

9 indirect costs by the revenue of retail telecommunications services

10 available for resale. See VZ-VA CS, Vol. VIII, Part F-6, Tabs 2 and

11 3.

12

13 **Q. Why did you use function code detail as the starting point of the study?**

14 A. As noted above, function codes are used by Verizon VA for accounting

15 purposes to categorize expenses. Verizon VA used the function code detail

16 as the study's starting point because at this level Verizon VA can accurately

17 identify and analyze the cost of the individual activities performed throughout

18 the corporation, which makes it simpler to determine whether or not they are

19 avoided in a resale context. Verizon VA cannot use the Commission's Part

20 32 main account level data because the Part 32 categories are too general to

21 make this determination. For example, the Part 32 main account Customer

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1 Services contains Service Center activities. In a resale context, carrier
2 service center activities are not avoided, while residence and business service
3 center activities are avoided; thus, it is important to begin the analysis at this
4 more granular level to obtain accurate results.

5

6 **Q. Why is it appropriate to use separated costs for determining the resale**
7 **discount?**

8 A. Verizon VA's expenses are allocated between the intrastate and interstate
9 jurisdictions through the separations process. Intrastate expenses are
10 recovered via intrastate charges, consisting generally of retail charges and
11 wholesale charges. Interstate expenses are recovered through interstate
12 charges, which generally consist of Switched Access charges, Special Access
13 charges and Subscriber Line Charges/End User Common Line charges
14 (SLC/EUCL). The intrastate resale discount is calculated using only those
15 expenses that are recovered in the intrastate rates, as that most accurately
16 identifies the relationship between the avoided costs and the retail services
17 through which these expenses are predominantly recovered.

18

19 **Q. In which accounts does Verizon avoid direct expenses?**

20 A. Verizon avoids certain expenses in accounts associated with selling,
21 providing, managing and maintaining the customers' services. Verizon

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1 avoids some of the expenses in the following direct accounts: Account
2 6611 – Product Management, Account 6612 – Sales, Account 6623 -
3 Customer Services, and Account 6533 – Testing. Verizon also avoids some
4 of the expenses in Account 5301 – Uncollectibles. These avoided expenses
5 are described in more detail below.

6
7 **Q. How did you determine the percentage of these accounts that are**
8 **avoided?**

9 A. As previously stated, each account was examined at the function code level.
10 If the total expenses for a function vary directly with the volume of service,
11 the expenses for that function are treated as completely avoided. This
12 method mathematically produces the correct result without having to forecast
13 the number of lines that will migrate to resellers or having to determine the
14 average cost per line of that function.

15 For example, suppose a retail florist sent a thank-you note to every
16 purchaser of a bouquet, incurring costs of 50 cents per bouquet purchased
17 (i.e., postage, stationery, etc.) If that florist sold 10,000 bouquets last year,
18 then he incurred \$5,000 for the “thank-you function.” Suppose further that
19 the average price for a bouquet is \$20, so that the total revenue he received
20 for bouquets was \$200,000. Now, if the florist decides to sell bouquets
21 wholesale (in which case he will not incur the “thank-you function” to the

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- 1 purchaser), he will avoid some costs. In determining what percentage of
2 revenue he will avoid, there are three equivalent calculations that can be
3 made:
- 4 (1) On each bouquet sold, he will avoid 50 cents for the thank-you. He
5 can determine that his avoided costs will be $2\frac{1}{2}\%$ of his revenues by
6 dividing 50 cents by \$20. This method can be used if you know the
7 cost per item for the avoided function as well as the average revenue
8 associated with the item.
- 9 (2) Suppose the florist were to assume that he would sell 10% of the
10 bouquets on a wholesale basis. He could then assume that 10% of his
11 revenue and 10% of his costs would be avoided. Then, \$500 divided
12 by \$20,000 will still yield $2\frac{1}{2}\%$. This method may be useful if you do
13 not necessarily know the cost per item for the avoided function or the
14 average cost of the item. However, it requires a forecast of the
15 number of units to be sold on a wholesale basis as well as knowledge
16 of the revenue and expenses on a total basis.
- 17 (3) The florist could look at the function in total. Then, \$5,000 divided
18 by \$200,000 still yields the correct percentage of $2\frac{1}{2}\%$. While
19 knowledge of the revenues and expenses on a total basis is still
20 needed, no forecast of demand is needed.

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1 In determining the appropriate retail avoided cost discount
2 percentage, Verizon VA employed the third method because it is
3 computationally simpler and yields the equivalent result without the need to
4 rely on forecasts.

5

6 **Q. How did you determine the avoided administrative support costs**
7 **associated with avoided functions?**

8 A. The costs associated with administrative support functions that Verizon VA
9 avoids were determined on the basis of the percentage avoidance of the
10 functions being supported. Thus, if Verizon VA determines that 25% of the
11 costs associated with a particular function would be avoided in a resale
12 context, then Verizon VA also treats 25% of the administrative support costs
13 for that function as avoided.

14

15 **B. EXPENSE CONSIDERATIONS**

16 **Q What expenses are avoided in Account 6611 – Product Management?**

17 A. A large portion of the account contains costs associated with the development
18 of Verizon VA's products and services. This development must take place in
19 a wholesale as well as a retail environment. For example, functions such as
20 rate and tariff development and identifying product requirements through a
21 product's life cycle are functions that are required to create and maintain a

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1 viable product that will be successful in either retail or wholesale markets. If
2 these functions are not performed, Verizon VA will not have viable products
3 to sell at retail — or wholesale. These costs therefore cannot be and are not
4 avoided simply because Verizon VA provides one of its retail services at
5 wholesale to a CLEC. However, there are costs in this account that are
6 avoided. These include work associated with developing and implementing
7 retail marketing programs, analysis of the retail marketplace and related
8 supervision and support costs.

9

10 **Q. What expenses are avoided in Account 6612 – Sales?**

11 A. The Sales account reflects costs incurred in performing functions related to
12 selling products and services directly to retail customers, such as the
13 determination of individual customer needs, development of customer-
14 specific proposals, processing of sales orders, and preparation of sales
15 records. Verizon VA treats all of the functions in this account as avoided
16 because none of these functions are performed by Verizon VA when it sells a
17 service to a reseller. These functions are performed by the reseller.

18

19 **Q. What expenses are avoided in Account 6613 – Product Advertising?**

20 A. None. This account includes costs incurred in developing and implementing
21 promotional strategies to stimulate the purchase of products and services

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1 generally. Effective product advertising stimulates sales of the product
2 whether the advertiser sells the product through a retail or wholesale sales
3 channel. Wholesalers commonly advertise to end users, even though they do
4 not sell directly to them, because increased end user product demand should
5 cause resellers to purchase more of the targeted product from the wholesaler.
6 Thus, Verizon VA would experience no reduction in advertising expenses
7 simply because some of its services were sold to resellers rather than directly
8 to end users.

9 Moreover, because resellers benefit from Verizon VA's product
10 advertising — end users will be stimulated to purchase more product not just
11 from Verizon but from the resellers — it is appropriate for resellers to
12 contribute to the cost of such advertising.

13

14 **Q. What expenses are avoided in Account 6623 – Customer Services?**

15 A. The avoided costs in Account 6623 consist of portions of Customer
16 Accounting and Service Center Functions.

17

18 **Q. What type of expenses are in the Customer Accounting portion of**
19 **Account 6623?**

20 A. Customer Accounting expenses are those incurred to issue and mail
21 customers' bills, as well as to receive and process payments. The primary

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1 activities associated with Customer Accounting are the creation and
2 maintenance of customer account files, the processing and rating of toll and
3 local messages, the monthly processing of customer accounts, the printing
4 and mailing of customer bills, and the handling of remittances associated
5 with those customer bills.

6

7 **Q. What Customer Accounting functions are avoided?**

8 A. With resale, the expenses associated with bill postage and billing and
9 collection functions for end users are avoided. Verizon VA will not render a
10 bill to the end user, but instead will provide bulk billing to the reseller. Thus,
11 these costs are avoided, but other costs included in Customer Accounting are
12 not.

13

14 **Q. Please describe more fully the functions associated with the Customer**
15 **Accounting activities that are avoided under resale.**

16 A The specific functions associated with the Customer Accounting account that
17 have been identified as avoided are as follows:

18 (1) **Remittance Processing** – This function includes the receipt of mail
19 payments from customers, public offices, and agencies within a
20 centralized operation. In addition, this function is responsible for
21 opening and processing the Centralized Mail Remittance payments

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1 and listing payment records. The costs are avoided because the
2 reseller will be responsible for collecting the end user's payment.

3 (2) **Accounts Processing** – This function is responsible for processing
4 mechanized and manual billing adjustments. In addition, this
5 function applies payments and credits and calculates the balance due.
6 The reseller will perform this functionality for the end user, so this
7 cost is avoided for Verizon.

8 (3) **Customer Billing** – This function separates, encloses and mails
9 customer billing outputs and treatment notices, and produces
10 automated collection letters. In addition, the expenses captured in this
11 function code include the cost of postage, the mailing of customer
12 bills, and customer bill stationery. Because the reseller will bill the
13 end user directly, Verizon avoids these costs. Administrative support
14 functions for the above activities are also avoided.

15

16 **Q. What Customer Accounting functions are not avoided?**

17 A. Customer Accounting functions such as recording, rating, and service and
18 equipment processing will still be required for the provisioning and billing of
19 resale services. Verizon VA must continue to record and rate the local and
20 toll messages, apply the appropriate resale discount, and forward this
21 information to the reseller. The rating must be done so that Verizon VA can

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1 bill the resellers and respond to reseller billing inquiries. Because Verizon
2 VA continues to maintain the resold access line and associated features, this
3 customer-specific service and equipment information must be stored and
4 requires continual updating. These activities and associated costs are not
5 avoided in a resale environment.

6
7 **Q. Please describe more fully the functions associated with the Customer**
8 **Accounting activities that are not avoided under resale.**

9 A. The specific functions associated with the Customer Accounting account that
10 are not avoided are as follows:

11 (1) **Toll Message Operations** – This function is responsible for receiving
12 and transmitting message records, as well as detecting and
13 distributing errors to the appropriate correction group. This activity
14 continues to be required for resale services.

15 (2) **Service Order/Accounts Master File Operations** – This function is
16 responsible for maintaining the database that associates an end user's
17 customer record information with the network facilities assigned to
18 that customer. This function continues to be required with resale
19 services.

20 (3) **Carrier Access and Cellular Customer Billing** – These functions
21 include accounting for toll, service order, remittance and customer

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1 billing operations associated with the billing of carrier access and
2 cellular customer revenues. These expenses continue to be required
3 in a resale context, and therefore are not avoided, because the network
4 access required by these carriers is not dependent upon whether the
5 reseller is purchasing local service or whether the end user purchases
6 service directly from Verizon. The same network is used to provide
7 service whether a reseller is involved or not.

8

9 **Q. What types of expenses are associated with Service Center Functions**
10 **included in Account 6623?**

11 A. The expenses included in the Service Center Function portions of Account
12 6623 are those associated with preparing, changing, and handling customer-
13 related service orders. In addition, they include expenses associated with
14 collecting revenues and handling miscellaneous customer relations, such as
15 billing and account inquiry, customer instruction, annoyance call complaints,
16 and customer records updates.

17

18 **Q. What Service Center functions are avoided?**

19 A. The functions associated with the Residence and Business Service Center
20 Functions that are avoided with resale are as follows:

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- 1 (1) **Residence and Business Service Center** – This function is
2 responsible for creating and transmitting residence and business
3 service orders to the field forces and receiving completed service
4 orders from the field forces. Resellers will perform this function for
5 their customers.
- 6 (2) **Account/Billing Inquiry** – This function is responsible for handling
7 residence and business customer billing inquiries and collecting
8 overdue and final accounts, as well as maintaining customer records.
9 Resellers will respond to their customers' inquiries.
- 10 (3) **Demand Sales** – This function is responsible for handling residence
11 and small business related matters with customers, discussing and
12 selling services, and maintaining customer records. Resellers will
13 negotiate with and sell services to their customers.
- 14 (4) **Customer Payment Operations** – This function is responsible for
15 receiving, depositing, and reporting customer payments with the
16 service center, and collecting from unpaid accounts. Resellers assume
17 responsibility for the collection of the end user's bill.
- 18 (5) **Centralized Operations Group** – This function is responsible for
19 negotiating with the customers' equipment vendors. These
20 negotiations include discussing service offerings, negotiating service
21 orders, and discussing credit terms with customers. In a resale

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1 environment, resellers will assume responsibility for these vendor
2 negotiations.

3 (6) **Customer Instruction** – This function is responsible for training and
4 instructing customers in how to use their telecommunications
5 services. Resellers will be responsible for providing customer
6 instruction.

7 Administrative support functions for each of the above activities are
8 also avoided.

9

10 **Q. What Service Center Functions are not avoided?**

11 A. The specific activities associated with Service Center Functions that Verizon
12 VA does not avoid are:

13 (1) **Annoyance Call Bureau** – This function is responsible for handling
14 inquiries or complaints concerning abusive, threatening, or obscene
15 calls. This work continues to be performed by Verizon for resold
16 services.

17 (2) **Premises Management Information System (PREMIS)/Street**
18 **Address Guide Bureau** – This function maintains and updates the
19 Mechanized Street Address Guide File and provides living unit
20 information. Verizon remains responsible for this function, and

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1 resellers use this database during the service order negotiation
2 process.

3 (3) **ICSC** – This function (Interexchange Carrier Service Center) is
4 responsible for processing and completing access service orders from
5 interexchange carriers. These expenses are not avoided when Verizon
6 sells service to a reseller.

7 (4) **Message Investigation** – This function is responsible for
8 investigating questions concerning toll messages, including toll fraud,
9 and for securing toll billing data. This function will be performed by
10 Verizon for both Verizon and the reseller.

11

12 **Q. What expenses are avoided in Account 6533 – Testing?**

13 A. The testing expenses that are avoided are those expenses associated with
14 Testing Subscriber Trouble Reports. This includes the subscriber line testing
15 associated with receiving, recording, and analyzing customer trouble reports.
16 With resale, an end user customer's call to report a trouble, currently made to
17 the Verizon VA Repair Service, would instead go directly to the reseller. In
18 addition, the initial trouble testing and processing that is currently handled by
19 Verizon VA's Centralized Repair Service Attendant Bureau (CRSAB) and
20 Customer Services Bureau (CSB) would be performed by the reseller. The
21 Testing Subscriber Trouble Reports in Account 6533 are therefore avoided.

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1

2 **Q. What testing expenses are not avoided?**

3 A. The specific functions associated with the Testing account that Verizon VA
4 does not avoid are as follows:

5 (1) **Subscriber Line Testing – Network Testing** – This includes the
6 testing of rearrangements and changes to network facilities, testing
7 requested by field personnel, and acceptance testing for construction
8 of new facilities. These expenses are not avoided because Verizon
9 VA will necessarily perform this type of testing for the services
10 provided to the reseller.

11 (2) **Interoffice Testing** – This includes the testing of facilities between
12 different central offices. These expenses are not avoided because
13 Verizon VA will necessarily perform this type of testing for the
14 services provided to the reseller.

15 (3) **Service Order Testing** – This includes the testing of facilities on
16 inward movement service orders (*e.g.*, requests for new service).
17 These expenses are not avoided because Verizon VA will necessarily
18 perform this type of testing for the services provided to the reseller.

19

20 **Q. How did Verizon VA treat uncollectibles in calculating the resale**
21 **avoided discount?**

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1 A. Although not booked as an expense according to FCC Part 32 rules,
2 uncollectibles are still a cost of providing service — a cost that will vary with
3 the level of sales. However, the cost of uncollectibles has nothing to do with
4 the level of expenses, avoided or not. It is a function of revenue and a
5 customer's ability to pay — whether that customer is an end user or a reseller.
6 With resale, Verizon VA had expected uncollectibles to decrease since it will
7 be collecting from a few resellers instead of millions of end users. Therefore,
8 in calculating the avoided cost discount percentage, Verizon VA treated a
9 majority of uncollectibles as being avoided. To determine the percentage of
10 uncollectibles associated with retail service, Verizon VA split out retail
11 versus wholesale uncollectibles by looking at four jurisdictions that tracked
12 this information separately in 1999. Verizon VA used the overall weighted
13 average of these four jurisdictions because these four jurisdictions are at
14 different stages of competitive development.

15

16 **Q Does Verizon VA's approach understate the avoided costs from**
17 **uncollectibles?**

18 A. No. In fact, Verizon VA's conservative approach overstates the avoided
19 costs and therefore inflates the resale discount. Recent data indicates that
20 resellers have entered and continue to enter the marketplace without the
21 proper financial backing, resulting in a larger number of bankruptcies and

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1 suspension of wholesale accounts than projected in Verizon VA's approach
2 to uncollectibles. Total uncollectibles have increased from a level of
3 approximately 1.0% in 1999 to approximately 1.4% in the year 2000.
4 Uncollectibles in 2001 are even higher. The wholesale uncollectibles rate (if
5 the revenue and uncollectible data from interexchange carriers are included)
6 is approximately 1.0% in the year 2000, and nearly the same in 2001 to date.
7 Excluding interexchange carrier data results in an uncollectible rate of over
8 7.0% for 2000 and 2001 (to date).

9
10 **Q. What Operator Services expenses are avoided when the reseller provides**
11 **its own Operator Services?**

12 A. The Call Completion, Directory Assistance and Operator Systems expenses
13 that are avoided when a reseller provides its own operator services are only
14 those expenses that exceed the revenues specific to these services, referred to
15 as the Operator Services shortfall. These shortfall expenses are related to
16 non-revenue producing calls (*e.g.* dialing instructions, rate information, etc.)
17 that are avoided if the reseller rather than Verizon VA is providing the
18 Directory Assistance and Call Completion functions.

19
20 **Q. How did you calculate the Operator Services shortfall?**

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1 A. Verizon VA calculated the Operator Services shortfall by subtracting
2 Operator Services revenue from total Operator Services expenses in Account
3 6621, Account 6622 and Account 6220.

4
5 **Q. Did Verizon identify avoided indirect expenses in calculating the resale**
6 **discount?**

7 A. Yes. The indirect expenses that are avoided include costs associated with
8 some of the functions reflected in Accounts 612X – General Support
9 expenses and Accounts 67XX – Corporate Operations expenses.

10

11 **Q. How were these avoided indirect expenses determined?**

12 A. The indirect avoided expenses were determined as follows:

13 (1) Each function code in the indirect expense accounts was analyzed to
14 determine if it directly supports an avoided direct function.

15 (2) These indirect expenses were classified as either fixed or variable
16 relative to the level of retail output. If the expenses are fixed, they are
17 not avoided. An example of this type of fixed expense is the expense
18 of information system programming and maintenance (Account
19 6724 – Information Management). This function does not vary based
20 on the level or the existence of retail output, and therefore, is not
21 avoided.

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1 (3) For those expenses that do vary with the level of retail output, each
2 function code was analyzed to determine the portion that is avoided.
3 As explained above, the amounts that are avoided are based on the
4 functions being supported. For example, if a certain percentage of the
5 expenses associated with a function or activity was avoided, Verizon
6 excluded the same percentage of infrastructure support, *e.g.*,
7 computers, from the relevant account.

8 (4) Finally, the general and administrative expenses (Account 6728) that
9 vary directly with the number of employees (*e.g.*, sickness and
10 disability payments) are avoided based on the ratio of avoided
11 intrastate direct expenses to total company intrastate direct expenses.
12 This avoided direct expense to total company direct expense ratio
13 would need to be calculated twice — once for the discount assuming
14 Verizon VA operators are used, and then again for the discount
15 assuming reseller operators are used.

16

17 **Q. In which indirect accounts did you identify avoided expenses?**

18 A. Based on the description of the methodology just discussed, Verizon VA has
19 identified avoided expenses in Accounts 6124 (General Purpose Computers),
20 6711 (Executive) and 6728 (General and Administrative). The other indirect
21 accounts (*i.e.*, 6121-6123, 6712, and 6721-6727) do not include functions

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1 that would be avoided when a reseller, rather than Verizon VA, provides
2 service to the customer.

3

4 **Q. Did Verizon VA include any plant-specific and plant-non-specific**
5 **expenses as avoided costs?**

6 A. No. Verizon is the provider of the underlying facilities used in the resale of
7 its services. Therefore, Verizon VA is responsible for the repair and
8 maintenance of its facilities, as well as the administration and powering of its
9 network. These costs, along with the depreciation and amortization expenses
10 of the facilities, cannot be avoided simply because an end user is taking
11 service from a reseller.

12

13 **Q. Can taxes be avoided?**

14 A. No. Taxation is one of the certainties of our economic system, and taxes will
15 be incurred regardless of who provides the service to the end user. Because
16 the resale discount is supposed to be based on the costs that Verizon VA will
17 actually avoid when a reseller rather than Verizon serves the end user, the
18 impact to Verizon's net income, and by extension to the taxes it pays, is zero.

19 A simple example illustrates this point. Assume that an end user's
20 service provides \$100 in revenue per month and the expenses associated with
21 the service are \$80 per month. The net income is then \$20 per month. If the

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1 tax rate is 35%, then the tax will be \$7 per month. Next, assume there is a
2 discount that has been calculated at 10%, and a reseller takes over the
3 account. Then the revenue will amount to \$90. However, the expenses
4 associated with providing the service through the reseller can be assumed to
5 drop to \$70 because the discount of 10% implies that there are \$10 of
6 avoided costs. Thus the net income is still \$20, and the tax implication has
7 not changed.

8		Service Provider	
9		<u>Verizon Retail</u>	<u>Reseller</u>
10	Monthly Revenue	\$100	\$90
11	Monthly Expenses	<u>\$ 80</u>	<u>\$70</u>
12	Net Income	\$ 20	\$20
13	Taxes @ 35%	\$ 7	\$ 7

14
15 **Q. Did Verizon VA offset from its calculation of the resale discount any**
16 **costs incurred as a result of resale?**

17 A. No. As a result of the Telecommunications Act of 1996, Verizon VA
18 incurred costs (and continues to incur costs) associated with opening up the
19 network to other carriers. These costs include the costs of establishing
20 service centers for CLECs and resellers, operating such centers, establishing

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1 access to Verizon VA's operations support systems with the appropriate
2 interfaces and functionalities, and supporting and maintaining such interfaces
3 and functionalities. None of these costs are used as offsets to the avoided
4 cost calculation in the avoided cost study because Verizon VA's
5 methodology looks at the costs on a function code basis and/or treats such
6 costs as part of separate rate elements.

7

8 **C. REVENUE CONSIDERATIONS**

9 **Q. The avoided costs discussed above are combined to calculate the**
10 **numerator in the calculation of the resale discount. Turning now to the**
11 **denominator in the calculation, what revenues must be excluded?**

12 **A.** The following revenues should be excluded from the calculation of the resale
13 discount:

14 (1) **Access Revenues** – These services are not subject to the resale
15 discount because they are not generally available to the public as
16 stated in the definition of telecommunications services used in the
17 Act. "The term 'telecommunications service' means the offering of
18 telecommunications for a fee directly to the public, or to such classes
19 of users as to be effectively available directly to the public, regardless
20 of the facilities used." 47 U.S.C. § 153(46). In addition, the
21 Commission stated in the *Local Competition Order* that the IXC must

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- 1 “purchase access services from incumbent LECs outside of the resale
2 framework of 251(c)(4), through existing interstate access tariffs.”¹⁷
- 3 (2) **Subscriber Line Charge (SLC) Revenues** – The SLC is not subject
4 to the resale discount rate. The *Local Competition Order* provides
5 that “[a]lthough incumbent LECs may continue to recover the SLC
6 when other carriers resell their local exchange services, the SLC is not
7 subject to the wholesale pricing standard of § 252(d)(3).”¹⁸
- 8 (3) **Nonregulated Services Revenues** – These revenues, as identified in
9 FCC Part 64 Separation of Regulated and Nonregulated Costs, are
10 associated with services that are not tariffed telecommunications
11 services (*e.g.* the installation or repair of customer premise inside
12 wiring).
- 13 (4) **Billing and Collection Service Revenues** – This service is not a
14 telecommunications service.
- 15 (5) **Miscellaneous Operating Revenues** – These revenues are excluded
16 since they are not associated with telecommunications services. They

¹⁷ *Local Competition Order* at 15982-83 ¶ 980.

¹⁸ *Id.* at 15984 ¶ 984.

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1 are revenues associated with Rents, Corporate Operations Activities,
2 and Other Incidental Regulated Charges.

3 (6) **Other Revenues** – Revenues associated with Cellular Mobile and
4 other Mobile revenues have been excluded.

5 (7) **All Interstate Revenues** – These revenues have been removed since
6 the resale discount to be determined by this Commission is to be
7 based on the relationship of avoided intrastate costs to intrastate
8 revenues.

9
10 **Q. Besides the overall categories mentioned above, what further**
11 **adjustments were made to the revenues in the calculation of the resale**
12 **discount rate?**

13 A. The study includes the revenues associated with those intrastate services that
14 are subject to resale. For resellers that use their own operators, Verizon VA
15 further adjusted the rate to exclude all Operator Services revenues.

16

17 **D. SUMMARY**

18 **Q. In summary, what are the resale discount rates that are appropriate for**
19 **Verizon VA?**

20 A. As mentioned earlier, Verizon VA has developed two discounts — a discount
21 for resellers who resell Verizon's Operator Services, and a discount for

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1 resellers who provide their own Operator Services. Verizon VA is proposing
2 the following discounts, which are displayed in Tab 1 of the resale study:

3	<u>Reseller using own Operator</u>	<u>Reseller Using Verizon VA Operator</u>
4	14.32%	13.06%

5

6 **Q. Should the discount apply to the resale of vertical services by resellers on**
7 **a stand-alone basis?**

8 A. No. As explained by Verizon witness Josephine Maher, Verizon VA does
9 not offer vertical services (*e.g.*, Call Forward Busy Line/Don't Answer) at
10 retail on a stand-alone basis. Moreover, the avoided retail cost discount
11 discussed above reflects the costs that Verizon VA would avoid if it were not
12 providing the service at retail. However, if the reseller were reselling only a
13 vertical feature, Verizon VA would continue to provide the basic dial tone
14 service and would not necessarily avoid any costs. For example, Verizon VA
15 would continue to incur the costs of taking retail customer orders and of
16 billing and collection. Thus, if the Commission determined that resellers are
17 entitled to a discount for stand-alone vertical services, it would have to
18 determine a separate wholesale discount rate for such services.

19

20 **Q. Does this conclude the Panel's testimony?**

21 A. Yes.